Beware of Factors That Will Increase Your Cost of Investment Real Estate Insurance

By Izzy Green

Investors are often surprised—even shocked—to learn the cost of insurance on a particular investment. Can you relate?

I've seen many investors estimate their cost of insurance based on what they've paid for another property. When they get their estimated insurance rate, they struggle to wrap their head around the figure, wondering why it's so different than a similar property they invested in.

When it comes to insurance it's important to know that not all properties are created equal. Understanding key differences can make insurance premiums a lot easier to navigate. Here are four factors that can have a serious impact on your insurance costs.

1. HIGH RISK TENANTS

Did you know that the type of tenant you have in your commercial property could affect the cost of your own insurance? Property owners often don't realize this and give little consideration to the type of tenant to whom they lease their property. It's only after they try to obtain an insurance policy that they're slammed with a higher-cost premium.

So, why exactly is it that the type of tenant you have can drive up the cost of the insurance on your building? It all goes back to risk.

Picture this: You have a full-service restaurant as a tenant on your commercial property with cooking exposure, resulting in a higher risk of fire. The tenant's insurance policy covers this higher exposure so your insurance as a landlord won't increase, right? Wrong. The higher risk of a claim your tenants' operations pose, the higher premiums you will pay — the tenant's insurance notwithstanding!

Property owners are sometimes surprised to learn that the type of tenants they have can dramatically increase their premiums. While some of these tenants infuse cash and add value to your property, the insurance company looks at factors that could result in a higher risk perspective.

How the premises are used will affect the property insurance rate. For instance, as we see from the example above, a restaurant carries a higher risk than other types of businesses would. As a result, it costs more to insure a restaurant. Of course, a restaurant isn't the only type of business that carries a higher risk.

Let's take a look at a few other types of tenants that carry a higher risk and will increase your premiums. Some of these tenants will add great benefit to your building, but increase the risk of insurance exposure nonetheless.

Subsidized/Section 8 Tenants – Section 8 tenants can be attractive to landlords, generating guaranteed rent paid for by the government. However, it's critical to keep in mind that insurance companies view subsidized housing as a high risk. Why? First, Section 8 tenants have less interest in maintaining a property that they don't really pay for. Second, there's often a higher crime rate that typically comes with low income tenants.

Laundromats and Auto Repair Shops – For a host of reasons, insurance companies have determined that these businesses have a higher risk of claims for the landlord than most businesses, thus increasing the cost of insurance. This is the case even when the tenant has their own insurance!

Housing a Daycare, Allowing Pets, or Hiring Armed Security Guards – These benefits can add tremendous value to your property and are a proven tools for tenant retention. However, they also dramatically increase the risk to your insurance company and premiums shoot up accordingly.

2. LOCATION, LOCATION, LOCATION

When conducting due diligence, investors often don't realize what the cost of insurance will be on their property. One of the reasons for this is that not all properties are created equal. Just because the building you're considering investing in is the same size or even the same type of building as a building you've invested in previously, the cost of insuring the properties could differ dramatically.

Consider this: You own a 100-unit brick building in Atlanta, Ga., and you pay $275 in insurance per unit. You're now looking at a similarly built 100-unit building in New York City and estimate that your cost will be around the same. Here's where the unpleasant news comes in. It could cost more than double because of the location. Liability insurance in New York City can be more than triple that of Atlanta, Ga. That's because of the foot traffic and the high percentage of lawsuits in New York. For this reason and more, it's always a good idea to get a real estimate of insurance based on your unique set of circumstances.

Properties located in high-crime areas will usually incur higher insurance premiums. Another factor to consider is whether your property is located in an urban area where there is easy access to a fire station or fire hydrant, which serves to lower your rates. By comparison, if your property is located further away from a fire station or fire hydrant, it might cost more to insure.

Surrounding neighbors can also impact the cost of insuring your building. For instance, suppose your property is located near a fireworks factory or a refinery. Obviously, there's going to be a greater risk that your building could be collateral damage in the event of an accident at one of those neighboring businesses. While it might not seem fair, that means there is a higher risk for a claim on your building, which will result in higher insurance premiums.

3. LAPSE IN COVERAGE

Have you ever had a lapse in your property insurance? If it's just a couple of days, it might not seem like a big deal, but in reality, a lapse of even a day or two could spell trouble later on. This is because liability insurance claims are based on the date they occurred, not when they're reported or filed as a lawsuit.

Think about this for a moment: You forgot to mail in your insurance premium a couple of years ago. Since your payment was late, you had lapsed coverage. Once you realized the error, you immediately mailed in the payment. Everything is good, right? Unfortunately not.

Since your payment was late, you'll be viewed as a higher risk and your insurance rates will rise accordingly. Remember, it's all about risk. Having a year or more with full coverage will usually give you the coverage history to restore your premiums to normal.

4. INCREASED COST OF CLEANUP

I recently had a claim on a $5 million property coverage for a 28,000-square-foot building in New York City. That's $175 in coverage per square foot, enough to build a whole new building! What the insured didn't consider was the cost to clean up after a fire. The cleanup and emergency work itself added an additional $50 per square foot.

Insurers often use an industry calculator such as Marshall & Swift to calculate the cost of rebuilding a property. It may be tempting to underinsure your property for cheaper premiums, but think twice before taking that risk, it could bite you later if a claim is made. ■